

Economic Commentary



Market Commentary for February 2009

The Turmoil Continues

The United States economy is, according to many experts, in its worst downturn since the Great Depression. Virtually no major economic indicators have improved since the onset of 2009. To help ameliorate this crisis, the federal government passed what President Barack Obama called "the most sweeping economic recovery package in our history." The \$787 billion stimulus package, which received no Republican support in the House and only three GOP votes in the Senate, is primarily a combination of spending on infrastructure, tax cuts, and bailing out cash-strapped states. This bill is separate from the financial bailout introduced last year and the housing rescue plan currently in the works. Some critics contend there are not sufficient job-creating aspects to the plan and that there is too much wasteful spending. Many economists believe, however, that the infusion of such a large amount of money into the economy will at the very least have a short-term stabilizing effect, likely in the fourth quarter of this year.

U.S. Gross Domestic Product (GDP) in the fourth quarter of 2008 was revised downward from negative 3.8 percent growth to negative 6.2 percent, making it the largest quarterly contraction in the economy since 1982. It is likely that GDP will continue to shrink until, as mentioned above, the fourth quarter of this year, where it will hopefully stabilize and then return to positive growth in 2010. The employment picture keeps getting worse and worse. More than 650,000 jobs were lost in the month of February. The unemployment rate surged from January's 7.6 percent to 8.1 percent, the highest rate since 1982. It is hoped the rate will top out at 9 percent in 2010 before it starts to come back down.

None of these negative indicators has escaped the notice of the consumer. The Conference Board index of consumer confidence plummeted to 25.0 in February from 37.4 in January, the lowest on record. Both of the two major components of the index, attitudes about present conditions and future expectations, fell sharply, suggesting a broad-based pessimism, which itself is likely to adversely affect aspects of the economy. Worries center on jobs and income, with 24 percent of consumers expecting lower wages in the

Sector Review

U.S. Treasuries: The market remained concerned about the potential nationalization of banks in the United States and abroad. Ben Bernanke rebuffed such concerns in his semi-annual Humphrey Hawkins testimony before Congress and helped quell market concerns briefly as bank earnings continued to show weakness. The 10-year note yield increased to a 3.01 percent yield from a 2.84 percent yield the prior month. The two-year note yield increased to a 0.97 percent yield from a 0.94 percent yield while the three-month bill saw yields increase from 0.22 percent to 0.24 percent. (Rates and prices maintain an inverse relationship. Prices decrease as yields increase).

Commercial Paper: Federal Reserve holdings of commercial paper (CP) in their Commercial Paper Funding Facility (CPFF) remained fairly steady at \$242 billion at the end of the month. The Bank of England announced a similar CP program which could drop some of the demand currently filled by the CPFF. The rollout of the Term Asset-Backed Securities Loan Facility (TALF) program by the Fed is also expected to lend some support to the asset-backed commercial paper (ABCP) community as some issuers may decide to use this program in lieu of issuing more CP. One-month, top-tier, higher quality ABCP names continued to trade between 0.40 percent and 1.25 percent and three-month paper traded between 0.65 percent and 1.75 percent.

near future and only 7.0 percent expecting higher income. As a result, consumer spending dropped 1.0 percent in January, although it edged up 0.4 percent in February. Even so, this follows a fourth quarter drop in real personal consumption expenditures of 4.3 percent annualized, downwardly revised from 3.5 percent. The savings rate jumped to 5.0 percent in February. The one bright spot is that spending does not appear to have fallen by such a degree to have had a profound effect on prices. Indeed the core Consumer Price Index (CPI) increased by 0.2 percent for the month of January and 1.7 percent year-over-year, which suggests that the economy has largely avoided deflation for now.

The situation on the business front is just as bleak. Manufactured durable goods orders dropped 5.2 percent in January, making for a 6 month consecutive decline. The Institute for Supply Management's (ISM) manufacturing index, which measures the health of U.S. manufacturing, barely rose from 35.6 in January to 35.8 in February. The index remains at very depressed levels. Figures under 50 are considered to be in recessionary territory. Manufacturing is likely to remain in the doldrums for some time because the demand for exports has plunged due to the appreciation of the dollar and of course the general economic malaise enveloping the globe.

As expected, the housing market continues on its downward spiral. Existing home sales fell by 5.3 percent in January and the median existing house price fell by 14.8 percent year-over-year. New home sales fared even worse with a decrease of 10.2 percent in January from December as the median price for a new home fell 9.9 percent in the same period. Year-over-year, new home sales have fallen by 48.2 percent, which places sales at their lowest level since tracking began more than 40 years ago.

There have been no further meetings of the Federal Open Market Committee (FOMC) since last month's edition and thus the federal funds target rate remains between 0.00 and 0.25 percent and will likely stay in that range for the rest of 2009.

U.S. Government Agencies: This month the Obama administration had announced multiple programs aimed at attempting to assist pressured mortgage holders. These programs will include an increased use of capacity at Fannie Mae and Freddie Mac to help facilitate the absorption of newly modified or newly originated loans created as a result of this program. Agency yields at month-end on three-month paper yielded near 0.20 percent, six-month paper yielded 0.50 percent, and 12-month paper yielded 0.90 percent.

Strategy: The Federal Reserve maintained its federal funds target range between 0.00 percent and 0.25 percent. The continued deterioration of labor market conditions and the decline in consumer spending, business investment, and industrial production are a source of concern for the Fed and create challenges for all asset managers. We continue to be very defensive in our strategy by attempting to maintain ample cash while trying to be very selective identifying and implementing trade opportunities to add yield available in the longer part of the money market curve.

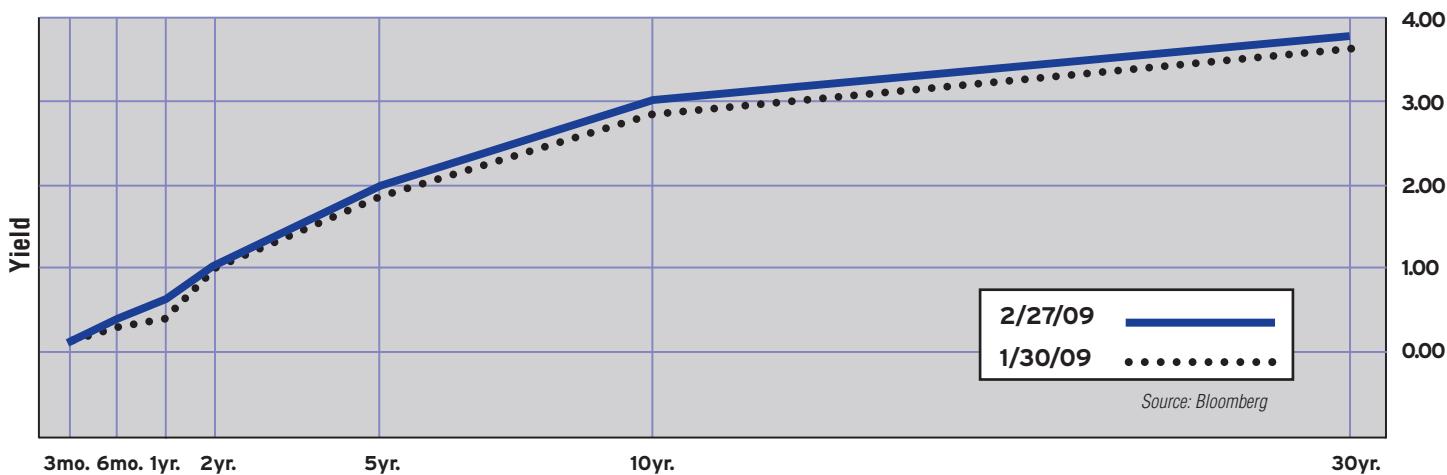


Market Summary for February 2009

Monthly Market Summary - Week-ending Rates and Yields

	02/06	02/13	02/20	02/27	1st QTR AVG
Overnight Rates					
Effective Fed Funds	0.23	0.22	0.20	0.22	0.18
Repurchase Agreements	0.20	0.25	0.20	0.20	0.18
Discount Rates					
1 Month Treasury Bill	0.23	0.20	0.18	0.15	0.11
1 Month Agency Disc.	0.24	0.28	0.28	0.23	0.18
1 Month Com'l Paper	0.38	0.39	0.38	0.35	0.34
3 Month Treasury Bill	0.29	0.29	0.26	0.24	0.18
3 Month Agency Disc.	0.38	0.36	0.40	0.36	0.31
3 Month Com'l Paper	0.70	0.75	0.66	0.81	0.71
6 Month Treasury Bill	0.39	0.42	0.44	0.43	0.31
6 Month Agency Disc.	0.52	0.54	0.55	0.55	0.47
6 Month Com'l Paper	1.11	1.24	1.05	1.09	1.07
Yields					
1 Year Treasury	0.57	0.61	0.64	0.72	0.53
1 Year Agency	0.86	0.94	0.87	0.81	0.74
2 Year Treasury	1.00	0.97	0.94	0.97	0.88
2 Year Agency	1.70	1.58	1.57	1.51	1.57
5 Year Treasury	1.96	1.87	1.83	1.99	1.76
5 Year Agency	2.85	2.71	2.63	2.76	2.64

Historical Yield Curve



Key Economic Indicators

	For the Period	Date of Release	Expected	Actual	Prior
Unemployment Rate	February	03/06	7.9%	8.1%	7.6%
Consumer Price Index	January	02/20	-0.1%	0.0%	0.1%
- Less Food and Energy	January	02/20	1.5%	1.7%	1.8%
Consumer Conf. (CB)	February	02/24	35.0	25.0	37.7
FOMC Rate Decision		01/28	0%-0.25%	0%-0.25%	0%-0.25%
Gross Domestic Product	4QP	02/27	-5.4%	-6.2%	-3.8%

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